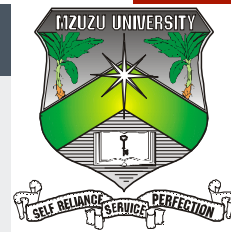


# Why financial lending institutions are not willing to provide services to the private sector for rural sanitation and hygiene (Malawi)



*The paper identifies funding mechanisms for private sector participation and provision of rural household sanitation facilities, within Nkhata Bay District, Malawi.*

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## Abstract

This study examines the gap between financial lending institutions and sanitation and hygiene services within Nkhata Bay District, Malawi. The study reviewed literature and policies, and conducted interviews, field observations, focus group discussions, household and lending institutions surveys, and peer reviewed workshops. Results suggest the following recommendations: promoting informal financial services, improving access for “risky” customers, improving knowledge for financial service providers, and promoting loan diversity. Although it has been found in Malawi households are willing to pay, cash, for improved sanitation, build-up of private sector businesses is hampered by lending institutions not willing to provide financial services.

## Introduction

With almost three quarters of the 2.5 billion people who lack an improved sanitation facility worldwide residing in rural areas, rural sanitation and hygiene services provided by the private sector simultaneously remain a global challenge and present an excellent opportunity for improving public health. This is particularly true in Malawi, where nationwide statistics indicate 92% of the rural population has an unimproved sanitation facility (WHO/UNICEF, 2014). Although Community Led Total Sanitation (CLTS) campaigns are active in Malawi (Malawi Government, 2011a), CLTS is not often combined with private sector build up through sanitation marketing.

There are several recent developments in the wider sector for private sector water and sanitation service participation. Carter and Danert (2003) observe the diverse players when looking at this topic:

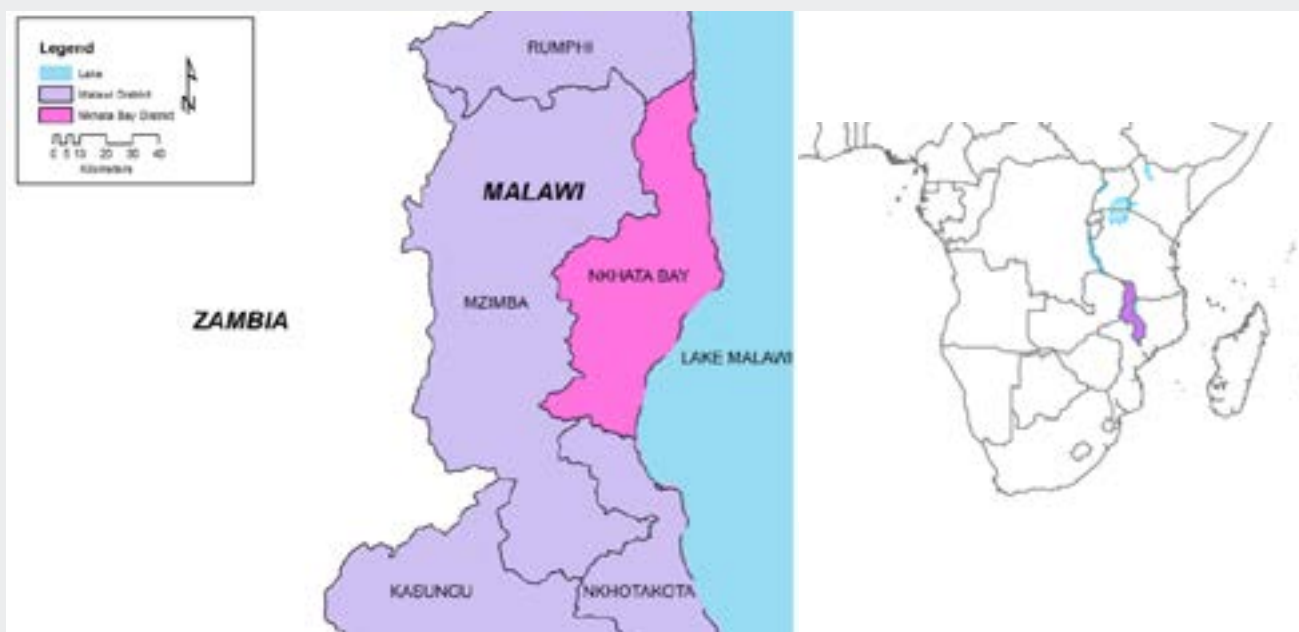
*One of the causes of conflict in the debate over private sector participation is the lack of mutual understanding and respect between diverse players, combined with an apparent unwillingness to be self reflective and, if necessary, self critical. A change in mindset is needed, which recognizes commonalities, values differences, and nurtures respect between diverse players.*

Schaub Jones (2011) supports the global interest in service opportunities for water and sanitation entrepreneurship, but also argues sanitation business models and service providers are unique, and different than most other business. Sanitation businesses provide “one off” services needed every few months or years rather than a daily supply as with water or food, demand in rural areas for mid-level sanitation services such as pit emptying services are limited, and technical support is more common than

## Key messages:

The following actions could help promote and build investment in sanitation in in Nkhata Bay District and other similar rural areas worldwide:

- In low income rural areas promote ongoing informal sources of finance and/or local micro finance institutions for private sector sanitation providers.
- Policy makers should support commercial financial institutions to provide loans to more „risky“ private sector sanitation providers serving rural areas.
- Sharing Government policies relating to sanitation and hygiene to financial institutions.
- Encouraging lending institutions to employ a non-monopolistic approach, e.g. allowing a small percentage of loans to be more sanitation diverse such as agribusiness loans for promotion of composting latrines



**Figure 1. Location of Nkhata Bay District, Malawi.**

business support for sanitation entrepreneurs. Trémolet (2012) similarly maintains sanitation economics can help to identify how market failures affect the ability to extend private sector sanitation services. In Malawi, Water for People (2013) has been at the forefront of promoting Sanitation as a Business, including offering an urban sanitation microfinance program. But, there is a gap in lessons learned for the private sector delivery of rural sanitation and hygiene.

This study examines the reasons why lending institutions are unwilling to provide financial services to small scale operators or prospective operators of sanitation and hygiene service delivery within the Nkhata Bay District, a low income rural district in northern Malawi (Fig. 1). The paper is divided into three main sections: Methodology, Results and Discussion, and Conclusion and Recommendations. The first section profiles water and sanitation conditions in Nkhata Bay, explains the study methodology, outlines the constraints facing financial institutions in reaching the private sector, and explores why leading institutions are unwilling to provide financial services to operators or prospective operators of sanitation and hygiene services. This second section explains why investment in sanitation should be promoted, and the paper concludes with a series of national and global level recommendations on how to better encourage lending institutions to provide sanitation related financial services.

## Method

The 2008 census shows Nkhata Bay District, located along the shore of Lake Malawi (Fig. 2), has a total population of 215,789, most of which is located within the rural areas (Malawi Government, 2009a). District wide, only 5% of households use an improved sanitation facility, defined as a flush toilet, ventilated improved pit latrine,

traditional pit latrine with a concrete slab, or composting toilet (Malawi Government, National Statistical Office and ICF Macro, 2011). Recent findings from Holm et al. (2014a) indicate there are opportunities, barriers, and threats in taking up rural sanitation as a business in the Nkhata Bay District and households – with both lower and higher levels of income – are, on average, willing to pay MK8,580 (£13) to move towards improved sanitation (Holm et al., 2014b).

Improvement of rural sanitation issues through the private sector is supported at the national level. Private sector participation in the delivery of sanitation and hygiene services in Malawi is directed by the National Water Policy (Malawi Government, 2005), National Sanitation Policy (Malawi Government, 2008), Microfinance Policy and Action Plan (Malawi Government, 2002), and the Public Private Partnership Framework (Malawi Government, 2011b), with the latter including sanitation as a specific business growth area.



**Figure 2: Nkhata Bay, Malawi (Authors)**

The ways and means by which this research was undertaken included: reviewing current literature and policy; capturing the current District situation through questionnaires with key informants, in depth interviews, field observations, focus group discussions (FGDs), 311 household and 6 lending institution surveys, and non-participant observation; peer review workshops; and data analysis. The study, and informed consent procedure, was approved by the National Commission for Science and Technology in Malawi.

## Results

This section summarizes our results concerning: why lending institutions may be unwilling to provide financial services, the level of willingness of microfinance institutions to operate in the sanitation sector, and reasons to encourage investment in sanitation in Malawi.

Nkhata Bay District has 6 banking and micro credit infrastructures based within the district, each of which has a head office in the town of Nkhata Bay (Table 1). None of the banking and micro credit infrastructures offers loans for sanitation projects or loans for businesses in the sanitation sector, respectively.

### What are the constraints around financial institutions financing the private sector?

Most financial institutions in this low income rural area are not yet offering sanitation related financial services; there are a number of reasons for this including: difficult conditions for accessing loans; lack of knowledge of loans

by institutions; lack of linkages between households and loan institutions; the fact that sanitation is new area of investment for many financial institutions; and the presence of a monopolistic approach in certain geographical locations.

The majority of rural sanitation entrepreneurs were found to be poor, with a very limited financial base or collateral for build-up of their business, and thus fail to access or qualify for loans from financial institutions. Rural sanitation entrepreneurs may not hold bank accounts at the time of business start-up, and yet most financial institutions will offer loans only to its customers whose accounts are good and have been in operation for at least six months. Furthermore, most financial institutions would only offer business loans to clients who have security in the form of fixed deposits or buildings with title deed, neither of which was found to be commonly held by rural sanitation entrepreneurs. There is also the geographic issue that the banking institutions in Nkhata Bay District are primarily located in market areas and may not, therefore, be geographically accessible to rural areas with regular frequency. Four of the six commercial banks operating in the district have no satellite branches outside the district centre. Yet, some rural areas are served through mobile banking which offers limited services on particular days. For these same reasons, households looking to purchase sanitation services from rural sanitation entrepreneurs with the assistance of a loan will also suffer geographical challenges.

**Table 1: Nkhata Bay District banking and microcredit infrastructures.**

Name of Banking / Micro Credit Infrastructures	Notes
Malawi Savings Bank	The bank attempted to offer micro credit to groups but realized that this service was best provided by such institutions as FINCA and Microloan Foundation. However, groups who benefit from such microcredits facilities bank their money with commercial banks such as MSB.
NBS Bank Limited	Commercial loans for big business with good track record.
Foundation for International Community Assistance (FINCA)	FINCA does provide general loans to individuals involved in business where household assets can be used as collateral. One individual involved in a sanitation project got a business loan – but not necessarily as a sanitation loan.
First Merchant Bank	FMB is currently not giving out any loans due to the unfavourable financial situation (high interest rates).
Microloan Foundation	Loans for sanitation projects are not offered to sanitation businesses but a special request may be made. Microloan Foundation targets rural women who access individual loans but in groups. The group acts as collateral. There is great emphasis on training. For Nkhata Bay District, the majority of the loans, 75%, are in fishing and the rest are for agricultural business.
Opportunity Bank Of Malawi	Loans for sanitation are not offered in Nkhata Bay District. But, loans for sanitation are offered in other Districts, including Blantyre through a loan guarantee fund program with Water for People.

It was found the private sector is often unaware of the type of loans provided by the financial institutions and of how they can be accessed. To someone who has never taken a loan, the prospect of starting the process may be uncomfortable, overwhelming and confusing, as different financial institutions offer different loan facilities. It was found there are only a few banks that heavily market and advertise their services and loan facilities. For Nkhata Bay District, it was observed some banks undertake financial service awareness campaigns but in FDG with financial service providers it was reported the campaigns had received poor response. This was further expanded because of a Malawian culture of financial secrecy whereby Nkhata Bay district residents often do not want to openly show they have money by publicly opening a bank account. It was also observed that even those people who open bank accounts still lack knowledge of banking processes. It is therefore recommended that information on banking procedures and practices should form part of entrepreneurship training, particularly for microcredit institutions that deal with small scale businesses. Financial service providers should also act to improve banking awareness.

Furthermore, results from a number of interviews with private sector sanitation service operators revealed that while sanitation loans were not formally offered in Nkhata Bay District, these small businesses often relied on the informal financial markets, i.e. loans from friends and family, for start-up capital. In fact, the results from this study found the primary financing for the private sector was on going informal sources of finance. This shows while financial institutions want to, and have to, limit their lending risks, there is some financing already happening and that the first step in scaling up sanitation loans may be with local microfinance institutions offering a 'personal' approach rather than large commercial banks.

Supporting Government policy exists, but there is a lack of clear linkage between households, Government, and financial institutions; most financial institutions, for example, were not aware of new developments and policies on sanitation and hygiene. It was observed in FDGs that representatives from financial institutions had low awareness on sanitation and hygiene issues and reported to rarely participate in Government sanitation meetings and programs. Instead, they mostly relied on findings from internal market research. However, relying only on internal market research may make it difficult for financial institutions to realize the potential benefits associated with supporting sanitation and hygiene promotion related businesses. At a small scale, the local Government should consider conducting open day sessions to showcase developments in the sanitation and hygiene sector with the six District financial service providers.

Although contained within the Nkhata Bay District Development Plan (Malawi Government, 2009b) sanitation is a new area of investment for many financial institutions in Malawi, especially for those located in rural areas. It was observed, knowledge of sanitation as a business opportunity was limited. This was especially evident in that, some financial institutions reported to have loan schemes for housing, but have not considered extending the same schemes to latrines and toilets. Most of the bank managers and heads of microfinance institutions interviewed could not see the link between sanitation and loans until it was explained to them that sanitation and hygiene could be a profitable business as part of this research. In several cases, it was reported corporate social responsibility initiatives by financial institutions place an emphasis on health, rather than sanitation facilities, although there is a strong link between sanitation and public health.

A number of financial institutions were found to focus their loan schemes on a narrow sector or geographical area of interest. It was noted the Microloan Foundation offers 75% of its loans to those involved in fish business and the remaining to agribusiness. Microloan Foundation did not diversify, for example agribusiness loans for promotion of composting latrines was not included. Other financial institutions focused on households in permanent employment for employer guaranteed loans, or on commercial loans for big business (outside the scope of rural sanitation service providers). In other cases, banks and financial institutions tended to avoid competition by focusing their services on particular geographical areas. Yet, there was a general feeling in the study household findings that banks should be legally mandated to offer services to the rural areas. However, FDGs further reviled the complexity of this issue in that banks are not willing to go into areas where there is little business, high cost, and limited security. During an FDG with the financial service providers, an example was provided of the nearby Likoma District, an Island district, which no commercial banks because of the challenges of security and transportation of money to and from the island. The administration cost of small loans in low income rural areas may overwhelm any potential profit margin by financial service providers. This is why most commercial banks are not interested in small loans and have deliberately left them to microfinance institutions, who in turn offer these loans at a higher interest rate to cover the high cost of administration. This situation leaves many rural areas without banking services, including loan facilities for the private sector or household. If supported by the Government, financial service providers could reach out to rural areas, in which case the services would be offered as a social responsibility activity, rather than as a profitable commercial venture.

## Why are institutions not willing to provide financial services?

There are a number of reasons why lending institutions are not willing to provide financial services to small entrepreneurs engaged in promoting sanitation and hygiene including: high level of risk; lack of proper collateral; no fast return on sanitation investment; lack of role models; and high administrative costs.

Lending institutions were found to tend to focus on reducing risk on their loans, and as such often do not offer loans to high risk customers for fear of running into losses. This limits the number and amount of loans accessible to small entrepreneurs, such as sanitation service providers. Unfortunately, there is no deliberate policy to finance the provision of this service as is the case in other sectors such as agriculture in the Microloan Foundation example provided above. Furthermore, FDGs indicated repayment rate for most loans in Malawi is low and leading to their high interest rates when loans are offered. During discussions with representatives from financial institutions, it was noted most business people are not trained in entrepreneurship, rendering them an even greater investment risk. Thus, there is a great need to train entrepreneurs in business management and in writing of sound proposals as it would reduce this perceived risk. Financial institutions are much more likely to fund well developed business proposals, regardless of the size, that are supported by evidence of business training; Microloan Foundation, for example, dominantly focuses on good business proposals and training when selecting which loans they grant rather than other selection criteria.

Results found no financial institution in the District would offer a loan without sufficient collateral as this might make it difficult for the institutions to recover the loans in the event of repayment default by the client. Unfortunately, the majority of potential rural beneficiaries, both private sector sanitation entrepreneurs and household customers, are poor and lack this required collateral. However, there were some financial institutions that used groups as collateral, a potential avenue for entrepreneurs to access loans. Group loans were reported to have lower default rate than individual loans, despite a lack of savings culture in Malawi. In addition, most banks indicated that savings could be used as collateral. Indeed, often people save with the purpose of accessing a loan rather than expanding their businesses. Another possibility for accessing loans is to have another institution or donor guarantee the loan, similar to urban Sanitation as a Business programs (Water for People, 2013). In such a case the guarantor would need to have an account with the bank which would become the loan guarantee fund. This is the approach that was used by the Opportunity Bank of Malawi which offered sanitation loans in Blantyre to households and entrepreneurs through a loan guarantee fund program with Water

for People. Receiving repayment was an issue for the Opportunity Bank of Malawi, particularly with regards to household loans, but the bank recovered the loans from the loan guarantee fund (Water for People, 2013).

Investment in sanitation does not confer fast returns as it takes a long time for projects of this nature to yield a return. As such, sanitation projects are not favoured by most lending institutions, particularly microfinance institutions. Preference for investment goes to services with fast returns such as fishing and public market vending. Thus, the challenge is to develop a sanitation and hygiene business model that would provide fast returns on invested money and encourage financial institutions to prioritize investing in this sector.

Sanitation in Malawi is a nascent sector and has not grown to a level attracting major financial investments. There are few successful entrepreneurs who can act as role models and attract the attention of lending institutions. For example, septic tank emptying in the District is a monopoly by one provider, Mr. Clean Malawi, who travels from outside the District. As such, most financial institutions do not see sanitation business as a promising venture with a pool of profitable role models.

## Why should investment in sanitation be promoted?

Promoting investment rural area sanitation further moves toward meeting the Millennium Development Goal (MDG) target for sanitation (United Nations, 2008). By providing financial services to the sanitation sector, lending institutions remove the need for hardware subsidies and may allow those at the base of the pyramid to take the first step towards attaining access to improved sanitation themselves. Furthermore, although financial institutions typically focus on healthcare to meet their perceived social responsibilities, improving sanitation can also confer positive impacts on the health of the population; currently poor sanitation and hygiene practices account for a high proportion of the burden of disease in Malawi especially for among children aged < 5 years (WHO, 2014). Furthermore, as private sector sanitation services expand, financial service providers will see the benefit of having an ongoing customer for both banking and loan services.

Investment in rural sanitation and promotion of the private sector by lending institutions is vital for promotion of:

- Meeting the MDGs
- Providing employment opportunities in rural areas
- Improving the health of rural communities
- Empowering rural communities to improve their own sanitation practices/facilities

## Recommendations

This paper serves to highlight and disseminate findings on why lending institutions are unwilling to provide financial services to small scale or prospective operators of sanitation and hygiene services; the level of willingness of microfinance institutions to operate in the sanitation sector; and reasons to promote investment in sanitation in Malawi.

Although there are six banking and microfinance institutions in the District, none are offering loans for household sanitation projects or sanitation business loans. Informal financial markets are currently serving as the primary provider for rural sanitation and hygiene financial services to the private sector, but this can only scale up so much.

The Government of Malawi Microfinance Policy and Action Plan (Malawi Government, 2002) outlines some problems for small and medium enterprises across sectors, which also apply to the delivery of sanitation and hygiene services in Malawi:

- Lack of collateral by clients
- Clients are assumed to be high risk and unable repay
- Cost of delivering credit and savings services is very high.

The plan also notes microfinance interest rates should not be subsidized, and includes the cost of account administration, loan losses, costs of funds including inflation and capitalization for growth (Malawi Government, 2002). This is also supported by the results of this study. For microfinance to work effectively, there needs to be a profit margin for both the lending institution, and also the private sector taking the loans.

The following actions could help promote and build investment in sanitation in in Nkhata Bay District and other similar rural areas worldwide:

- In low income rural areas promote ongoing informal sources of finance and/or local micro finance institutions for private sector sanitation providers.
- Policy makers should support commercial financial institutions to provide loans to more “risky” private sector sanitation providers serving rural areas.
- Sharing Government policies relating to sanitation and hygiene to financial institutions.
- Encouraging lending institutions to employ a non-monopolistic approach, e.g. allowing a small percentage of loans to be more sanitation diverse such as agribusiness loans for promotion of composting latrines

Although it has been found in Malawi households are willing to pay cash for improved sanitation facilities, the build-up of private sector businesses is hampered by lending institutions not willing to provide financial services. Recommendations and findings from this study can assist others working in Malawi and elsewhere, in both support of sanitation, hygiene and water private sector providers.

Why lending institutions are not willing to provide rural sanitation and hygiene financial services in a rural district of Malawi has been shown to be multifaceted, and requires the public health and financial sectors to overlap in a way never done before to fill this gap. The solution to sanitation problems in Malawi may be first to establish the commercially viable private sector which includes informal and formal financial sector backing.

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